The IPP Advantage for Business Owners and Executives

By Tracy Broeze, CFP

In a world of downsizing and cost cutting, many companies have found it necessary to limit or eliminate participation in the coveted Defined Benefit plan. The DB plan simply provides a clearly definable and usually dependable income in retirement. I say 'usually' because of the pension standoff at Stelco in 2010 that saw retired employees lose their indexing amount and new employees lose participation in the defined benefit plan altogether. If the providing company remains stable and profitable, pension benefits for retired employees are likely to remain steady and are therefore a highly sought after employee benefit. There is no market risk to the employee since the income is defined and paid for by the company.

Most companies are now moving toward a Defined Contribution structure wherein both the employee and the employer contribute to an investment plan. The risk for this type of plan is completely on the employee. The growth of the plan and subsequent income available in retirement are a result of the rate of return earned within the plan. Without careful administration, this type of plan is often neglected and invested outside of personal risk parameters. With oversight, this type of plan is great for younger employees with lots of compounding time available to them. Not so great for older, newly participating workers.

For those who have no pension plan at work, the traditional RSP is still the best tax deduction and income deferral opportunity available. The RSP is basically a personal, self-funded pension. There is a limit to how much you can put in an RSP however, and many high-earning, executive level employees and business owners are frustrated by the cap placed on their contributions. Again, age is a factor. Many business owners spend their younger years reinvesting all excess earnings into their company and have a limited time to ramp up their retirement savings. They are forced to consider selling their business in order to retire.

The alternative for executives and business owners is the Individual Pension Plan. The IPP is simply a one-person pension plan that will provide steady, reliable income. Since it is self-funded, the uncertainty that Stelco retirees felt in 2010 is no longer a risk. The account is creditor proof and relies on the account holder's ability to generate income not the success or failure of a bargaining committee.

The IPP can be considered a 'super-sized' RSP. The parameters and contribution limits are set by the government, as in RSP's, but the difference is in the limits. IPP limits are significantly higher than RSP limits and allow for past service contributions and pension top ups. All IPP contributions are made by the company as part of compensation and are fully deductible to the company.

IPPs are designed to be invested conservatively to reduce risk. The assumed rate of return for the IPP is set at 7.5%. If the target return is not achieved by the conservative investment selection, the government requires a top up amount, again tax deductible to the company, adding additional retirement funding without exposing retirement assets to undue risk. This is a second advantage that the IPPs have over RSPs. If an RSP drops in value, you are not offered a top up option. Your RSP limit remains restricted.

IPP contribution calculations are prescribed by the government, so there's no creative math going on, and you can be sure that the IPP numbers will be the same no matter which actuarial firm you use. The key is in the planning. Make sure you have an advisor who is thoroughly versed in IPP structures, ideally one who has their own IPP and has been through the process first hand.